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# SFC Publishes Consultation Conclusions On The Draft Guidelines On Disclosure Of Price Sensitive Information

## Introduction

The Securities and Futures Commission published, on 11 February 2011, Consultation Conclusions (the **Conclusions**) regarding the draft guidelines (the **Guidelines**) on the disclosure of price sensitive information (to be called "inside information" in future) by public listed corporations in Hong Kong. The Guidelines, which aim to foster a culture of continuous disclosure among public listed corporations, are to be published under section 399 of the Securities and Futures Ordinance (**SFO**). They were received in a largely positive fashion by the 19 respondents to the [SFC Consultation Paper of March 2010](https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=dii&type=1&docno=1) ([see archive](openFile.pdf)) which introduced them.

The Guidelines discussed in the Conclusions are part of a wider effort by the Hong Kong government to tighten up the regulatory framework governing the disclosure of price sensitive information and will operate in parallel with a new statutory obligation on listed corporations to disclose price sensitive information (i.e. "inside information") under the Securities and Futures (Amendment) Bill 2011 (the **Bill**). The aim of the Guidelines is to aid market participants to understand their responsibilities under the disclosure requirements which are to be inserted into Part IIIA of the Securities and Futures Ordinance (**SFO**). With this central goal in mind, the Guidelines give advice on the interpretation of the term "inside information" and on how the safe harbours and carve outs from the regime operate.

The SFC state in the Conclusions that the Guidelines are to be revised following the introduction, in the 2010/2011 legislative session, of the Bill imposing a statutory requirement to disclose inside information. These revised Guidelines will incorporate the feedback from the market discussed in the Conclusions. A final version of the Guidelines will then be published after the Bill has been cleared through the Legislative Council.

This newsletter is best read in conjunction with that of 22 February 2011 on the FTSB's [Consultation Conclusions](http://www.sfc.hk/sfc/doc/EN/speeches/public/consult/psi_conclusions_paper_eng.pdf) ([see archive](psi_conclusions_paper_eng.pdf)) regarding the new statutory regime for regulating the publication of price sensitive information, available [here](/newsletters/hklaw/en/2011/112/nl-hklaw-20110222-112.html).

## The Legal Status of the Guidelines

The SFC stated in the Consultation Paper that the Guidelines are designed to assist issuers in interpreting, understanding and applying the new statutory regime for disclosure of inside information. They are not legally binding and do not have the force of law. In response to queries from respondents to the Consultation Paper, the Conclusions clarify that non compliance with the Guidelines is not an offence in itself, but will be considered when assessing whether the requirements of the statutory regime have been satisfied and whether any enforcement action is to be taken.

## Application of the Guidelines to the Insider Dealing Regime

Under proposed section 101B(1) of the SFO, inside information is defined as that which the insider dealing regime prohibits a person from using when dealing in the shares of a listed company. It is specific information that:

1. is about:
   1. the corporation;
   2. a shareholder or officer of the corporation; or
   3. the listed securities of the corporation or their derivatives: and
2. is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

This is the same definition as that given to "relevant information" in section 245 of the SFO, which forms part of the regulatory framework for insider dealing detailed in Parts XIII and XIV of the SFO. This overlap was highlighted as a source of potential confusion by one participant, who sought clarification on the interaction between the Guidelines and the insider dealing regime. In the Conclusions the SFC stated that the Guidelines relate primarily to the disclosure of inside information regime outlined in Part III of the SFO and do not refer to the insider dealing regime bar the definition of "relevant information". The SFC committed in the Conclusions to amending the Guidelines in order to make it explicit that they are not relevant to the application of Parts XIII and XIV.

## The SFC's Consultation Service

In the Consultation Paper the SFC proposed to set up a consultation service which issuers could avail of in relation to their disclosure requirements. Although this idea received very positive feedback, some respondents had inquiries regarding the scope of the service, particularly regarding whether or not it would extend beyond advice on safe harbours and whether or not the SFC would be prepared to state whether a piece of information amounted to inside information. In response to these points, the SFC stated that it would be giving advice on the interpretation of the definition of inside information, the obligations and procedures imposed by statute and, in appropriate circumstances, on the applicability of safe harbours. However, the SFC have now ruled out giving tailored advice on whether a specific piece of information constitutes inside information, as that is a judgment that must be made by the issuer with reference to its own circumstances and knowledge of its own affairs.

A further key concern expressed by respondents in this area was the length of the consultation service, which the SFC had proposed originally to be 12 months. Following requests from market participants, the SFC have agreed to extend this to 2 years, with a review and possibility of further extension at the end of that time.

## What kind of information amounts to Inside Information?

### The Guidelines' incorporation of the decisions of the tribunals in previous Insider Dealing cases

As noted above, the definition of inside information is identical to that of relevant information, contained in section 245 of the SFO, which forms part of the regime for tackling insider dealing. Insider dealing cases in which the Market Misconduct and Insider Dealing tribunals address the scope of "relevant information" can therefore provide valuable guidance to interpreting the concept of inside information. In recognition of this, the SFC provided, in an annex to the Consultation Paper, a list of relevant cases in which the tribunals addressed the issue of "relevant information". The Consultation Paper also provided a summary of the main points of these cases, bringing together the key factors which make a piece of information "inside information":

* the information about the particular corporation must be specific;
* the information must not be generally known to that segment of the market which deals or which would likely deal in the corporation's securities;
* the information would, if so known, be likely to have a material effect on the price of the corporation’s securities.

One respondent questioned the exclusion of the Tingyi case[[1]](#footnote-34) from the list annexed to the Consultation Paper. The SFC responded that much of the guidance from the tribunal in this instance was case specific in nature and therefore not suitable for incorporation into the Guidelines. The SFC did state however that the annex to the Consultation Paper would be expanded to include all insider dealing cases which the tribunals have addressed.

### Whether the information is regarded as information that is generally known

In order to constitute inside information, the information must not be generally known to those who deal or who would be likely to deal in the corporation's securities. Two respondents expressed the belief that analysts' research reports, electronic subscription news and wire services are widely circulated among institutional investors and should be regarded as information that is generally known. However the SFC pointed to the guidance given as to inside information in the Guidelines, which is derived from the aforementioned decisions of the tribunals, which states that the investors who are to be regarded as "accustomed to dealing" in the corporation's securities encompass not just institutional investors, but retail investors also. Consequently, information on electronic subscription news broadcasts and wire services cannot automatically be regarded as generally known information, as very few retail investors have access to such data.

The SFC go into further detail in the Conclusions by giving advice to the market on when information covered in the media and analysts’ reports and by wire services can be regarded as generally known. Citing the requirements of clause 101B(3)[[2]](#footnote-36) of the indicative draft legislative provisions to be inserted into the SFO[[3]](#footnote-37), the SFC state that issuers should take into account the extent to which the information has been disseminated, the comprehensiveness and accuracy of the information, and the extent to which the market can rely on it. Further factors which the SFC demand that issuers give "particular" focus to are whether these media reports are comprehensive enough to meet the disclosure standard of section 101B(3), whether the market is aware that this information is equivalent to that held by the corporation and whether the market is likely to dismiss such information as the mere opinions of those external to the corporation. Where any of these factors are in doubt, the SFC state that the information cannot be regarded as generally known, and must be disclosed by the company itself. The SFC also undertake in the Conclusions to enlarge the Guidelines in order to give more advice on the publication of information in certain circumstances.

### Whether the information is likely to have a material effect on the price of the securities

The Guidelines state that to qualify as inside information, the information must be likely to have a material effect on the price of the securities. One respondent put forward the idea of an additional alternative method of evaluating the materiality of the information in question, the "investor decision" test. This asks whether there is a substantial likelihood that a reasonable investor would consider the information important in making his investment decision. After noting that this approach is very similar to that adopted by the tribunals[[4]](#footnote-39) and the EU when addressing the issue of materiality, the SFC announced its intention to integrate this investor decision test into the Guidelines.

### When do Management Accounts amount to Inside Information?

The SFC discussed in the Consultation Paper the circumstances in which management of a corporation have an obligation to disclose information which they possess and the market does not. In setting out when such information must be disclosed, the SFC differentiated between day to day general information and specific information which may have a substantial effect on the affairs of the corporation.

With regard to the company's results, information in this area (e.g. of major losses) which comes to the attention of managers must be disclosed where it is likely to cause a discrepancy between the results that the market expect and those which the company will actually publish. Furthermore, the SFC's draft Guidelines note that in evaluating what the results which the market expect for a company are, regard must be had to profit projections by analysts and information concerning the corporation in financial publications from which a sophisticated investor may predict the corporation's results. Confusion is added to the situation however by another part of the paragraph in question, which notes that it is not a good idea to regard these research reports or financial publications to be generally known to the market. As two respondents highlighted, the issue therefore arises as to whether or not the company must disclose if the results the directors know and the results the research analysts expect are largely the same.

In the Conclusions the SFC state that as a result of the inconsistency and inaccuracy of media reporting, as well as the divergence in opinion on the prospects of many corporations, an issuer must not consider information from such outlets to be generally known and is required to make separate disclosure of inside information. The Guidelines are to be amended to be more expansive on this point. Additionally, the SFC state that issuers have a responsibility to disclose any inside information in their possession, which could be used to correct a significant misunderstanding about the company contained in media reports.

Other respondents queried what course of action a corporation experiencing temporary declines in its results or variations in the valuations of its financial assets should take as regards disclosure to the market. The SFC's response in the Conclusions is that if such variations or declines are due to seasonal patterns and track the patterns of other years, there may not be an obligation to disclose. However, if the market develops such that an issuer sees a massive drop in the fair value of its financial instruments, such information is possibly inside information and must be disclosed.

## Examples of possible Inside Information Provided in the Guidelines

A number of respondents made the observation that the collection of events and circumstances noted in the Guidelines as constituting inside information overlap with the regime for disclosure of notifiable transactions set out in Chapters 14A and 14 of the Listing Rules, thereby indirectly giving elements of these chapters statutory force. Other respondents complained that the situations listed in the Guidelines were not specific enough, with the effect that nearly every corporate action would be capable of being construed as inside information. These respondents sought more clarity on when such events would actually be regarded as inside information. The SFC responded to these arguments in the Conclusions by emphasising that the list of events and circumstances which may constitute inside information is not a complete list and is illustrative in nature. The fact that an event is on the list does not mean it is certainly to be regarded as giving rise to an obligation to disclose as inside information, just as exclusion from the list doesn’t automatically result in a situation not giving rise to such an obligation.

The SFC also underline that it is to be expected an overlap will occur between what constitutes a notifiable transaction and what constitutes inside information. This overlap does not mean, according to the SFC, that the Listing Rules have been codified in a circuitous fashion.

A final point in this area came from a selection of respondents who claimed that the event of "pledge of the corporation's shares by controlling shareholders" should be cut from the list given as it is already regulated by the disclosure of interest regime under Part XV of the SFO. However the SFC pointed out that not all such pledges are inside information and those that are must be disclosed as such, to enable investors to tell the difference.

## When and how should information be disclosed?

### "As soon as practicable or "immediately"?

As regards timing of disclosure, the meaning attributed to the phrase "as soon as practicable" by the Guidelines is that "the corporation should immediately take all necessary steps that are reasonable in the circumstances to disclose the information to the public. A number of respondents claimed the existence of an internal contradiction between the concepts of "immediately" and "as soon as practicable". Other market participants raised the question as to whether issuers would be permitted to take "relevant" steps, such as commencing an investigation of the matter, bringing legal advisers into play or attempting to substantiate the information prior to making a disclosure.

The SFC address the apparent contradiction in the language of the Guidelines by first highlighting the fact that the aforementioned FTSB Consultation Conclusions on the new statutory disclosure regime for inside information proposed amending clause 101 (B) to replace the requirement to disclose "as soon as practicable" with one to disclose "as soon as reasonably practicable". This, note the SFC, has the effect of clarifying the timing of disclosure clause by emphasising that "as soon as reasonably practicable" refers to the act of disclosure whilst "immediately" refers to the taking of the required steps in preparation for the disclosure. As regards the taking of the relevant steps discussed by the respondents, the SFC confirms that it will make clear that listed corporations are allowed to go through such validatory processes before making any disclosure.

## Responsibility for Compliance and Management Controls

### Definition of Officers

Under the SFO, an officer is defined as "a director, manager or secretary of, or any other person involved in the management of, the corporation"[[5]](#footnote-46). This definition was criticised by a number of respondents to the Consultation Paper, on the grounds that it is too wide and covers those who are too junior to be involved in the decision to disclose inside information. The SFC took the opportunity in the Conclusions to clarify how the definition was to be interpreted, stating that the policy intention behind the definition is to encompass directors and high-level individuals responsible for managing the listed corporation, but not middle management or low-ranking staff. Further guidance will be provided in the Guidelines, as the SFC emphasise that as a general rule one must examine the circumstances at hand and the objective of the legislation when ascertaining whether an individual qualifies as a manager. The SFC note "A 'manager' normally refers to a person below the board level who is charged with management responsibility affecting the whole of a corporation or a substantial part of the corporation".

Finally it should be remarked that the SFC, in the Conclusions, state that the Guidelines will provide guidance on the matter similar to that given in the UK in the context of a "person discharging managerial responsibilities within an issuer".

## Requirement to implement reasonable measures to ensure proper safeguards exist to prevent a breach of a disclosure requirement

An assortment of respondents opined that the Guidelines did not give any assistance to directors and officers in taking reasonable steps to ensure the existence of proper safeguards designed to avert the breach of a disclosure obligation. Another respondent felt that this duty of directors and officers should be delegable, and would even be more effectively observed if it were so.

The SFC countered the respondents by noting that the creation of proper safeguards is a responsibility of the issuer and it is best placed to devise a system which caters to its own circumstances and meets all obligations. Guidance however will be provided through the publication of FAQ's by the SFC. Examples of the recommendations they may contain are listed in the Conclusions and include installing systems to monitoring business and corporate developments and events, establishing financial reporting procedures to ensure a structured and timely flow of key financial information, and authorising designated officers through whom any potential inside information will be reported and escalated to the attention of the board.

The suggestion that these responsibilities may be delegated by the board and the company's officers is rejected by the SFC, stating that accountability in this matter must rest ultimately with these particular corporate representatives.

## Safe harbours permitting the non-disclosure of financial information

### Disclosure of inside information to selected persons when withholding disclosure by virtue of a safe harbour

According to the terms of clause 101 D (2), a corporation taking advantage of a safe harbour is permitted to disclose the information in question to another person who needs that information to execute a function in relation to the corporation taking advantage of the safe harbour, conditional on that person having a duty of confidentiality to the corporation. A market participant asked that the SFC provide more details on the operation of this aspect of the safe harbour regime. The SFC pledged to amend the Guidelines in order to detail the situations where this exception may be availed of and also who may do so.

### Where information relates to an incomplete proposal or negotiation

Safe harbour B of the new disclosure regime relates to information concerning incomplete negotiations or proposals. A number of respondents queried whether this safe harbour could be availed of by a corporation in financial distress which was in negotiations aimed at alleviating or curing that distress, in order to allow non-disclosure of its financial condition. After examining the issues, including the fact that the interests of existing shareholders and those of potential investors in the company may diverge in such scenarios, the SFC stated that safe harbour B is applicable only to disclosure of information relating to negotiations concerning a potential corporate rescue, and not to the actual financial state of the corporation itself. The key reason given by the SFC for this restriction on Safe Harbour B is the need to protect the integrity of Hong Kong's capital markets.

### Safe Harbour C - Where the information concerns a trade secret

A number of respondents asked for guidance on what constitutes a trade secret, with some being concerned that it is likely to be interpreted too widely and others that it will be read too narrowly. The SFC took these comments into account, and pledged to alter the Guidelines in order to better explain what is meant by the term trade secret. Guidance is offered in the Conclusions, with the SFC noting that it may usually be taken to mean proprietary information owned by a listed corporation:

1. which is employed in a trade or business of the corporation;
2. which is confidential (not publicly available);
3. which if revealed to a competitor, would be likely to cause real or significant harm to the corporation's business interests; and
4. the publication or dissemination of which must be controlled by the corporation.

Furthermore, the SFC state that the revised guidelines will include a clarification stating that a corporation cannot consider the commercial terms and conditions of a contractual agreement or the financial information of a company to be trade secrets, due to the fact that these are not proprietary information or rights owned by the corporation.

### Where disclosure is waived by the SFC

A common recommendation from respondents related to the processes via which the SFC dispenses waivers from disclosure of inside information obligations and the procedures to be followed by parties seeking to appeal against a non-grant of waiver, with widespread calls being made for greater transparency and guidance from the SFC in these areas. The SFC heeded these calls, with the Conclusions announcing the expansion of the Guidelines in order to ensure greater transparency and instruction with regard to the granting of waivers and the making of appeals. However the SFC refused to adopt the suggestion of another market participant, that specifics of the waivers awarded by the SFC be published, due to the confidential nature of the information which such waivers concern.

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1. The case is set out in the Insider Dealing Tribunal report dated 11 January 2007 on Tingyi (Cayman Islands) Holding Corp. [↑](#footnote-ref-34)
2. Information disclosed by a listed corporation must not be false or misleading as to a material fact, or false or misleading through the omission of a material fact. [↑](#footnote-ref-36)
3. See Annex 1 to the Consultation Paper. [↑](#footnote-ref-37)
4. An approach based upon the decision of the Malaysian Court in Public Prosecutor v Alan Ng Poh Meng [1990] 1 MLJ. [↑](#footnote-ref-39)
5. Part 1 Schedule 1 of the SFO. [↑](#footnote-ref-46)